

Sales/Use/Indirect:

Arizona Court of Appeals Addresses What Constitutes Processing Under Use Tax Manufacturing Exemption

Case No. 1 CA-TX 23-0003, Ariz. Ct. App. (11/7/24). Affirming summary judgment for the Arizona Department of Revenue in a case addressing whether a taxpayer that sanitizes hundreds of thousands of pounds of textiles (linens) on a weekly basis and rents them to customers in the healthcare industry qualifies for Arizona's use tax manufacturing exemption, an Arizona Court of Appeals (Court) addressed at length the meaning of "processing" and held that the taxpayer in this case failed to qualify. In doing so, the Court explained that the definition of "processing" under state law contemplates a product that is converted to a marketable form, rather than a service as was performed here. Moreover, the Court noted that while it is undisputed that the taxpayer performs "mechanically and chemically intense, high-volume, industrial-scale sanitization," it is also undisputed that the taxpayer owns, rents, delivers, and collects the textiles that it sanitizes (*i.e.*, the taxpayer sanitizes its own property, which is eventually returned to be sanitized again). In this respect, according to the Court, the taxpayer is not introducing new products to the market, but instead is restoring the original article for repeated use and thus was not performing a processing function for purposes of the exemption. Please contact us with any questions.

URL: <https://www.azcourts.gov/Portals/0/OpinionFiles/Div1/2024/1%20CA-TX%2023-0003%209WHalo%20v.%20ADOR.pdf>

— Scott Schiefelbein (Portland)
Managing Director
Deloitte Tax LLP
sschiefelbein@deloitte.com

Metisse Lutz (Denver)
Senior Manager
Deloitte Tax LLP
mlutz@deloitte.com

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